In the Supreme Court
OF THE
United States

OCTOBER TERM, 1944

No.

J. R. MASON,
Petitioner,
vs.
GLENN-COLUSA IRRIGATION DISTRICT,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

FACTUAL BACKGROUND OF THE CASE.

The District Court denied the petition of the respondent (herein referred to as the "district") for a final decree discharging its indebtedness. The Circuit Court reversed.

The facts and proceedings, an understanding of which is necessary, are these:

The Glenn-Colusa Irrigation District is a public corporation for governmental purposes and was formed in 1924 by the consolidation of two districts

theretofore organized under "the California Irrigation District Act", Cal. Stats. 1897, p. 254 as amended.[1]

The consolidation act is Cal. Stats. 1921, p. 1018. (R. 2.)

The area of the district is approximately 121,592 acres located in Glenn and Colusa Counties, California. (R. 3.)

The district incurred or became liable (upon the consolidation) for 6% coupon bonds aggregating $1,248,453.16 in principal amount (R. 4) payable from revenue derived from ad valorem taxes upon the lands (not improvements) but the board may levy water tolls in lieu of assessments. (R. 4.)

The Reconstruction Finance Corporation purchased and held 95% of the bonds when the instant bankruptcy proceeding was commenced (R. 6) November 29, 1937. (R. 23.)

Certain creditors (including petitioner) answered (R. 24) and after the hearing on the bankruptcy petition the District Court confirmed the plan (R. 56) April 16, 1940. (R. 69.) The findings further than reciting the legal conclusion that the plan was fair (R. 54) lacked the specific findings required by the decision in *Kelley v. Everglades Drainage Dist.*, 319 U.S. 415, 63 S. Ct. 1141, although petitioner made this objection. (R. 69.) An appeal from the interlocutory decree was dismissed. (R. 75.)

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[1]Now embodied in Water Code Div. 11, Ch. 368, Cal. Stat. 1943.

The absence of adequate findings in this case however made it difficult for Judge St. Sure (on motion to deny a final decree) to determine what the truth was as to the ability of the district to pay in view of the district's established ability to borrow $802,500. (R. 11-16.)

From Exhibit "A" attached to the bankruptcy petition (R. 11-16), it appears that prior to October 19, 1934, the district applied to the Reconstruction Finance Corporation for a loan and was awarded a loan "not exceeding $802,500", which was accepted by resolution of the district October 19, 1934. (R. 11.) The Court, it is presumed from the many cases reviewed, will judicially note the use of the words "not exceeding" occurs in the R.F.C. form of bond refinancing contract.

The "plan" contained in this R.F.C. contract was reaffirmed as a plan of composition September 11, 1937 upon its acceptance by the R.F.C. as such. (R. 16.)

The amount actually made available to the creditors was only $660,943. (R. 133.)

The district applied for a final decree. (R. 83, 85.)

J. R. Mason on behalf of himself and the other creditors (R. 143) objected to the entry of the final decree. His principal contention was that the plan submitted to the Court was not carried out. (R. 143.)

This was done by motion and statement (R. 97) and affidavit (R. 100; see appendix A p. ii), on January 11, 1943. (R. 96.)

Counsel for the district filed his counter affidavit. (R. 132; see appendix B p. v.)

These two affidavits show substantially all the facts as the basis of Judge St. Sure's first order denying the petition for final decree (without prejudice) entered February 24, 1943. (R. 142, 148; see appendix C p. vii.)

The district attempted to make a further showing (R. 149) which was countered (R. 288) but Judge St. Sure finally denied the petition for final decree June 2, 1943. (R. 294; see appendix D p. xiv.)

The district appealed June 11, 1943 (R. 296) and the Circuit Court reversed. (R. 311, 318.)

The district admits the ability to borrow $802,500. (R. 133.) It only used $660,943 of this loan to enable the R.F.C. acquire 96% of the bonds.

At the time of the issuance and sale of the refunding 3¼% bonds this was cut down to $425,000. (R. 133.)

The district entirely paid off the R.F.C. (R. 98) and liquidated the old debt out of Court by a new 3¼% issue of bonds sold at a saving of $27,000. (R. 101.)

OPENING STATEMENT.

The gist and heart of respondent's position was that Section 83(f) of the Bankruptcy Act, 11 U.S.C. 403(f) (see appendix A p. i), makes it the duty

of the Court to enter a final decree when the district makes available for all its creditors the consideration proposed in the plan of composition.

This section was very carefully framed and for an express purpose, namely, to prevent any interference by the Bankruptcy Court with the political or governmental affairs of the district.

Indeed, in the case of *U. S. v. Bekins,* 304 U.S. 27, 58 S. Ct. 811, the case in which the constitutionality of the present law was upheld, U. S. Webb, Attorney General of California, with the Attorneys General of six other states, in their A. C. brief, discussing subsection (f), and in arguing that the amended bankruptcy law (then known as Chap. X) in no way interfered with the political or governmental affairs of the state, said:

> "this confirms the purely voluntary nature of the proceeding authorized by Chapter X. Of course, the district is bound by its agreement with the creditors who have accepted the plan, but it is bound under its general authority from the State to make contracts, and not by virtue of the decree of the bankruptcy court, and it is only when the consideration for the composition has been posted by the debtor that the decree itself becomes binding upon the dissenting creditors."

And Mr. Robert Jackson, arguing on behalf of the United States in that case in his brief before the Court of which he is now a member, at page 80, referring to the former Municipal Bankruptcy Act, declared:

> "The order of the court, approving the plan of readjustment, was binding not only on the creditors but also on the taxing district. Section 80(g)"

And from that the Attorney General of the United States argued that the present Bankruptcy Act is wholly voluntary in nature and that the volition or consent of the district, or in other words its veto power, continues to the very end until the district has actually met its contract or proposal in full, and not until then is it binding. Mr. J. R. McBride, in his brief for the Lindsay-Strathmore Irrigation District in the Supreme Court in that case, alludes to the fact that "Chapter X in its corresponding provisions (Sec. 83 (f)) omits the provision making the order or decree binding upon the taxing district. The district is bound by its composition agreement. No other binding force is necessary or provided for."

Well now then, it may be true that in a case free from any of the implications, facts and circumstances preceding the final decree as in this case, the debtor is entitled to a final decree, when it has made available the consideration provided for in the plan.

But that does not mean that the interlocutory decree is binding under all circumstances nor does it mean that the debtor cannot meanwhile freely abandon the plan and thereby become disentitled to a final decree.

On the first point, whether an interlocutory decree is binding, we agree that generally speaking any matters determined by an interlocutory decree are

res judicata. This does not mean that the interlocutory decree cannot be changed, set aside, amended or otherwise modified by the Court as are all other interlocutory decrees. Nor does it mean that it cannot be set aside for breaches of good faith, deviation from the terms of the composition plan or decree, fraud, or for any other circumstances which might appear to justify such action by a Court of Equity.

Thus in *American United Mutual Life Insurance Company v. Haines City, Florida*, 117 Fed. (2d) 574, it was held that an interlocutory decree entered in a municipal bankruptcy case is not final:

> "It may be that some matter has been overlooked, or has subsequently arisen, which makes the plan unworkable, and complicated, but which could easily and justly be remedied. Surprise or mistake may affect it. There ought to be some leeway for such adjustments."

Declaring further:

> "Like other interlocutory judgments it remains in a measure in the court's control if not appealed from."

This decision of the Fifth Circuit is cited as authority by the Seventh Circuit in the recent case of *Re Chicago M. St. P. & P. R. Co.*, 138 Fed. (2d) 235, in which the Court declared:

> "Since the proceedings and orders of a bankruptcy court are interlocutory until entry of the discharge (citing cases, including the above) and may be modified and rescinded before final decree, Simmons Co. v. Grier Bros., 258 U.S. 82, 42 S.

Ct. 196, 66 L. Ed. 475, and if no intervening rights will be prejudiced, the court may grant a rehearing, Wayne Gas Co. v. Owens-Illinois Glass Co., 300 U.S. 131, 137, 57 S. Ct. 382, 81 L. Ed. 557."

In the *Wayne Gas Co.* case this Court held that a bankruptcy Court has no terms and may vacate even a final decree in its discretion, even though the appeal period has expired.

See also *Wright v. Board of Public Instruction,* 142 Fed. (2d) 577.

THE DISTRICT COURT OPINIONS.

These opinions appear at pages vii and xiv of appendices C and D and they contain about all of the information that is necessary for a determination of this case.

Judge St. Sure, shows in his memorandum and his order setting aside the submission, the amount which the R.F.C. at all times offered to loan, $802,500 (R. 143), the fact that the indebtedness was paid down to $425,000 (R. 144); and points out that the debtor does not deny Mr. Mason's allegation that it was able to sell and had sold 3¼% bonds, instead of 4% bonds as provided by the plan of composition, resulting in an interest saving of $27,000 for the district; the debtor does not deny that it paid $12,000 to a Chicago firm to bid on the bonds; that the 3¼% bonds were sold to the public by another firm in excess of 101. Judge St. Sure points out that Mason contends the

creditors are equitably entitled to the benefits of these substantial savings; the difference between $802,500 and $425,000 plus the $27,000. Judge St. Sure refers to the case of *Lorber v. Vista I. D.,* 127 Fed. (2d) 628, which the Court remanded for further findings or evidence to determine whether the amount proposed by the plan was all that the district could pay, and points out that it follows that if in carrying out the plan the district does not need to pay what it represents itself as being able to in the plan of composition, then it has not paid all it is reasonably able to pay in the circumstances.

Judge St. Sure's conclusion (R. 146) is that there has been a deviation from the plan, indicating further that the creditors may not only be entitled to the saving made by the district in paying off the R.F.C., but the difference between the interest payable on 3¼% refunding bonds and the 4% bonds, authorized in the plan.

The District Court points out that the consideration which the Court had found to be fair and equitable was not in fact delivered to the creditors. While they received the percentage of their claims provided for in the plan, it has developed that they were entitled to a higher percentage.

Judge St. Sure put his own construction upon the interlocutory decree, and concluded that $802,500 was the measure of ability to pay. Furthermore, in the affidavits for appellant, no material variation from the statement of the matter and showing as contained in the judge's opinion appears.

Petitioner pointed out (R. 291) as the heart of the controversy the following:

> "Where a public debtor has established by interlocutory decree that its ability to pay its creditors amounts to $802,500.00 and where the debtor had hidden assets in the sense that their value was hidden, but which immediately enabled the debtor to pay substantially fifty per cent (50%) out of those assets which it theretofore represented as being of little value, and where the debtor further changes its plan of composition by borrowing from another source, cheaper money, effecting further savings amounting to many thousands of dollars as shown in the affidavits and admissions in this case, is the court bound nevertheless to enter a final decree which would result in enrichment of the debtor and in inequity and injustice to the creditors?"

Petitioner's position is that it does not make any material difference whether the plan of composition offered $802,500 or only offered $660,943, because the following considerations are, he submits, ample to sustain the District Court's decision:

1. The admitted saving of $27,000 in the refinancing of the proposed 4% indebtedness was sufficient to warrant the Court in making its decision; the district makes no offer to share this admitted saving with its creditors.

2. The admission of the fact that the district was able to pay the indebtedness to be composed with $425,000 instead of $660,943 or $802,500 is not satisfactorily explained. This bankruptcy proceeding continues until it is closed. It is submitted that until the

order of discharge is entered the matter is open for proper orders by the Court.

3. The debtor has unquestionably abandoned the plan of composition, before discharge.

4. The debtor has entirely liquidated the original bonded indebtedness of $1,415,033.30 upon which the whole proceeding is based; the original bond issues and warrants which have formed the basis of the composition proceeding have been entirely discharged and paid off. This was done during the course of the proceedings between date of the entry of the interlocutory decree and the application for discharge. It makes no difference if this occurred after the entry of the interlocutory decree any more than if it had occurred before the hearing on the interlocutory decree. The fact is that the debt is totally discharged. This discharge of the indebtedness is in itself sufficient and compelling reason for the District Court judge's decision.

5. A point which is somewhat related to the foregoing is that there is no creditor "consent" further remaining.

6. The plan provided for issuance and delivery of 4% bonds to the R.F.C., not sale of 3¼% bonds to bond underwriters.

7. The district also developed unexpected or hidden assets in the disposal of 65,000 acres of land sufficient to reduce the debt to $425,000. (R. 132.)

8. The use of $12,000 paid to Nuveen & Co. to induce the bid of that firm (who did not get the bonds)

distinctly was not any part of the plan of refinancing appearing in the Court proceedings. The respondent has not shown good faith or frankness with the Court; none of this money saving or new refinancing was shown to the Court, nor does appellant offer to share with the creditors anything of the savings admittedly made.

ARGUMENT.

I. THE COURT'S JURISDICTION OVER THE PROCEEDING, PARTICULARLY AS TO DISTRIBUTION, CONTINUES UNTIL DISCHARGE.

In *Meyer v. Kenmore Granville Hotel Co.*, 297 U. S. 160, at 164, 56 S. Ct. 405, the Court said:

> "But we think it plain that an order confirming a plan of reorganization under section 77B is not the equivalent of a judgment granting or denying a discharge, for, unlike confirmation of a composition, see section 14c, 30 Stat. 550, 11 U.S.C., paragraph 32(c), 11 U.S.C.A., paragraph 32(c), it does not operate as a discharge. The release of a debtor in a reorganization proceeding is contingent upon the performance of its part of the reorganization plan * * * Discharge is effected not by confirmation of the plan but by the final decree. Confirmation of a plan of reorganization is but a step in the administration of the debtor's estate."

It will be observed that Section 32(c) specifically provides that confirmation of a composition "shall discharge a bankrupt from his debts" etc. No such provision is found in the statute under consideration.

The analogy is more to the reorganization statutes in this respect.

Bankruptcy estates may be considered to be in administration as long as there is an asset in the Court's control.

In re Paramount Publix Corp., 82 Fed. (2d) 230.

In *In re Broadway Hotel Co.,* 131 Fed. (2d) 120, at 122, the Court declared:

> "Appellant mistakenly relies upon In re Corona Radio and Television Corporation, 7 Cir., 102 F. 2d 959, in support of his contention in this respect. In this case we held the court without jurisdiction for the reason that the relief sought was inconsistent with the reorganization plan. Before final decree, however, there can be no doubt, but that the court retains jurisdiction of the subject matter. By statute it is expressly authorized to change or modify the plan under certain circumstances." Certiorari denied 63 S.Ct. 664, 665.

The plea of *res judicata* does not embrace the proposition that the Court cannot interpret, control or set aside or amend its prior orders.

American United Life Ins. Co. v. Haines City, Fla., 117 Fed. (2d) 574;

Gentry v. City of Fort Lauderdale, 125 Fed. (2d) 52;

Wayne Gas Co. v. Owens Ill. Glass Co., 300 U.S. 131, 137, 57 S. Ct. 382.

II. THE INTERLOCUTORY DECREE CANNOT BE BINDING ON THE COURT AND THE COURT'S CONSCIENCE SINCE NOT BINDING ON THE BANKRUPT.

We have shown that Chapter IX was specially designed to prevent the plan of composition becoming binding on the district until it should give its consent by making the consideration provided available for its creditors.

That being so, the jurisdiction of the Court to refrain from granting a discharge for reasons of overreaching, fraud, inequity, subsequent developments, bad faith or mistake seems obvious.

The language in *American United Mutual Life Ins. Co. v. City of Avon Park,* 311 U. S. 730, 61 S. Ct. 395, is of considerable significance, where the Court remarks that the power of the Bankruptcy Court is not dependent upon the statute. "It inheres to the jurisdiction of a court of bankruptcy." While perhaps referring to a somewhat different situation, the Court's views are of great importance. Here it is declared:

> "Equity and good conscience obviously will not permit a finding that an acceptance of a plan by a person acting in a representative capacity is 'good faith' where that person is obtaining an undisclosed benefit from the plan. We have emphasized that full disclosure is the minimum requirement in order not to imply that it is the limit of the power and duty of the bankruptcy court in these situations."
>
> "Where such investigation discloses the existence of unfair dealing, a breach of fiduciary obliga-

> tions, profiting from a trust, special benefits for the reorganizers, or the need for protection of investors against an inside few or of one class of investors from the encroachments of another, the court has ample power to adjust the remedy to meet the need."

What we are trying to say is that a mere plea of *res judicata* as to one step in the same proceeding is not sufficient to bar the Court, in the same proceeding, before final discharge, from reopening matters that pertain particularly to distribution of the benefits or the execution of the plan itself. It certainly never was contemplated when the interlocutory decree was entered by Judge Louderback that the district, before it should apply for its discharge would be able to reduce its indebtedness from $800,000 to $425,000. Nor does it make any difference whether the reduction was from $802,500 or $660,943 to $425,000. The fact of its reduction is sufficient basis for the Court to set aside the whole proceeding. Whatever this benefit is, belongs to all the creditors, not just J. R. Mason, whose action is for the benefit of all who are entitled. (R. 138.)

III. A PLAN ABANDONED CANNOT FORM THE BASIS OF A DISCHARGE.

The case of *Ware v. R. E. Crummer & Co.*, 128 Fed. (2d) 114, was an aftermath of the case of *American United Mutual Life Ins. Co. v. City of Avon Park*, 311 U. S. 138, 61 S. Ct. 157. Testimony was taken as to the status of the composition proceedings and

whether another feasible plan could be submitted. Certain funds had been or were about to be withdrawn from the bond and sinking fund. When the mandate of the Supreme Court came down the city appeared unable to devise any plan to substitute for the one which had been rejected, and the Court in effect held that it had no further jurisdiction over the fund or in the matter.

In the case of *Leco Properties v. R. E. Crummer,* 128 Fed. (2d) 110, the Court held that the jurisdiction of the Bankruptcy Court in municipal composition proceedings depends upon the debtor's volition and cannot be extended by the Court beyond that volition. The Court here declared "normally the plan of composition failing, the Court may not administer upon the funds gathered by the city".

When the bankrupt has itself departed from the plan how can it profess its volition?

The effect of these two decisions is to hold that the jurisdiction of the Court depends upon the consent of the debtor and its creditors.

We desire respectfully to call the Court's attention to an article by Mr. Giles J. Patterson of Florida, who was chairman of the Municipal Law Section of the American Bar Association and who has been intimately connected with the development of the Municipal Bankruptcy Act. He writes in an article in the University of Pennsylvania Law Review, Vol. 90, No. 5, and in discussing subdivision (f) has this to say concerning distribution:

> "Some have assumed that the interlocutory decree may authorize the debtor to make distribution of the new securities. The act provides otherwise. Distribution can be made only by the court in its final decree. Distribution made before final decree is at the risk of all parties. If inequity or unfairness result from distribution before a final decree of confirmation has been made, creditors who accept the new bonds will not be protected by the interlocutory order."

Now we think that is a very significant observation. It coincides with the established bankruptcy principle that jurisdiction continues until discharge.

Therefore, where the debtor abandoned the plan of composition and goes into some other plan, such as here, by paying off the principal debtor in full and refinancing elsewhere, there is no longer any consent; there is in effect an abandonment of the plan.

IV. WHEN CONSENT FAILS THE PLAN FAILS.

Composition is a contract, which here is abandoned by one party, who thereafter cannot compel enforcement.

In the case of *In re City of West Palm Beach,* 96 Fed. (2d) 85, the Court pointed to the importance of identity of interest. While the practical effect of this case has been possibly affected by the later enactment by Congress of subdivision (j), nevertheless, the principles proclaimed are still sound. These are that the consent of the creditors must be based upon a bona fide interest. But after a precise plan of compo-

sition has been so accepted, based upon such consent, and the bonds upon which the consent is based during the time of the pendency of the proceeding, are entirely eliminated and wiped out, it is impossible to see how there is any jurisdictional basis for the entry of the final decree. It is just the same as if consenting bondholders had come into Court and said: "We have all been paid in full". The plan of composition must fail with that failure of consent.

No creditor consent survives the cancellation of the bonds.

Wright v. Coral Gables, 137 Fed. (2d) 182.

The Court declared, referring to the basis upon which a plan of composition can be enforced:

> "That base, * * * is the identity of interests of those consenting with those compelled, by their consents to accept the plan."

This decision was affirmed.

City of Coral Gables v. Wright, ...U.S..... (No. 388, Mar. 13, 1944), 64 S. Ct. 779.

Absent the consents of the State, the debtor, and the required per cent of creditors affected by the plan, the Court is without jurisdiction to issue any order or decree, interlocutory or final, and its jurisdiction cannot be extended by the Court beyond that volition.

The jurisdiction of the Court is dependent upon consent of the district.

Green v. City of Stuart, 135 Fed. (2d) 33 (U.S. Supreme Court on Nov. 8 denied petition for rehearing, 12 L.W. 3162).

The debtor must consent to the final decree, but if it is not in a position to consent to the final decree, how can it consent?

The cause is moot.

V. THERE MAY EVEN BE CIRCUMSTANCES WHERE A PLAN OF COMPOSITION CONFIRMED BY INTERLOCUTORY DECREE MAY BE SET ASIDE PRIOR TO DISCHARGE BY FINAL DECREE.

We submit that even in this case, where the interlocutory decree has become final, there were circumstances and factors brought to the Court's attention prior to discharge by final decree which justified the Court, particularly when considered with all the other matters discussed supra, in the action taken.

We refer to the case *In re Bay County, Florida,* case No. 83, M., Bankruptcy, U.S.D., Northern Dist., Fla., Marianno Div., Jan. 6, 1942, where the Court dismissed the petition saying:

> "The credit of the county is now such that, during the pendency of these proceedings, it was able to obtain a contract to purchase a new issue of refunding bonds at 3, 3¼, 3½% interest for cash in amount sufficient to pay on February 1, 1941, all of the outstanding refunding bonds issued under the Plan of 1932. The underwriters in that contract are charged with knowledge of the existence of the amount of unrefunded bonds and accrued interest thereon."

The district did not act in good faith. On the contrary it showed bad faith. It liquidated its indebted-

ness and never informed the Court until brought in by the petitioner.

CONCLUSION.

It is submitted that a writ of certiorari should be granted, the decree of the Court below reversed and the proceeding directed to be dismissed.

Dated, Turlock, California,
August 23, 1944.

Respectfully submitted,
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Counsel for Petitioner.

(Appendices A, B, C and D Follow.)